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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1959

## No. 596

ASHBY O. STEWART, Executor of the Last Will and Testament of Mary W. Stewart, Deceased,
*Petitioner,*

vs.

UNITED STATES OF AMERICA,
*Respondent.*

**PETITION FOR A WRIT OF CERTIORARI**
**to the United States Court of Appeals**
**for the Ninth Circuit.**

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vs.

UNITED STATES OF AMERICA,
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## PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above case on June 18, 1959, insofar as said judgment reverses the judgment of the United States District Court for the Northern Disfriet of California, Southern Division.

## OPINIONS BELOW.

The opinion of the District Court (R. 34-49) is reported at 158 F. Supp. 25. The opinion of the Court of Appeals (R. 67-77) is reported at 270 F.2d 894, and is set forth in the Appendix at pages 1-16. The opinion of the Court of Appeals on a petition for rehearing (R. 80-82) is reported at 270 F.2d 903, and is set forth in the Appendix at pages 19-23.

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## JURISDICTION.

The judgment of the Court of Appeals was made and entered on June 18, 1959 (R. 78), and is set forth in the Appendix at pages 17, 18. A petition by petitioner herein for a rehearing was denied on September 28, 1959 (R. 79-82). The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

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## QUESTION PRESENTED.

Whether the interest of a wife in insurance policies on the life of her surviving husband, which interest arises solely from the use of community property funds for the payment of premiums thereon, is upon her death the subject of a taxable transfer under the federal estate tax laws, notwithstanding the rule of local law that she has no interest in such policies which passes from her by will or by succession.

## STATUTES INVOLVED.

Internal Revenue Code of 1939, Secs. 810, 811(a), (c) and (d) (26 U.S.C., 1952 ed., Secs. 810, 811);

Civil Code of California, Secs. 161a, 164, 172;

Probate Code of California, Sec. 201.

The above statutes are set forth in the Appendix at pages 24-30.

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## STATEMENT.

This action was brought by petitioner in the District Court for recovery of federal estate taxes, and was tried entirely on the pleadings and a written stipulation of facts (R. 34). Jurisdiction was conferred on the District Court by 28 U.S.C. Sec. 1346(a)(1).

Three issues were presented to the District Court (R. 53). One issue (First Count) was conceded by the Government. A second issue (Second Count) was decided by the District Court partly in favor of the taxpayer and partly in favor of the Government (R. 54), and this determination was affirmed in its entirety by the Court of Appeals (R. 77, 78). No review is sought of the Court of Appeals' judgment insofar as this affirmation is concerned.

The District Court decided the third issue (Third Count) in favor of the taxpayer (R. 55), but this determination was reversed by the Court of Appeals (R. 77, 78), and review is now sought of this reversal. The factual setting for this issue can be summarized as follows:

A. O. Stewart and Mary Stewart were married in 1906 and their marital relationship continued until Mary's death on February 21, 1951. They were residents of California at all times pertinent to this case (R. 25, 34-35).

At the time of Mrs. Stewart's death, there were twenty-six insurance policies outstanding, covering the life of her surviving husband, all of which had been purchased by the payment of premiums out of the community property funds of Mr. and Mrs. Stewart (R. 29). No part of the value of these policies was reported in the U. S. Estate Tax Return for the estate of Mary W. Stewart. On audit of that return the Commissioner of Internal Revenue determined that one-half of the $751,178.85 cash value of these policies as of the date of the decedent's death should be included in her gross estate, and a deficiency based on this determination was assessed and paid (R. 29, 30). A claim for refund was filed and rejected and this action was brought in the United States District Court for recovery of the amount so paid (R. 10, 23, 30).

The insurance policies themselves were attached as exhibits to the stipulation of facts in this action and were made a part of the record on appeal to the Court of Appeals, although they were not printed (R. 64), and are therefore not a part of the transcript of record filed with this petition (R. 83).

The policies were in the customary form and the following is a summary tabulation of the pertinent rights thereunder:

| Policies Under Which Wife Was Named Primary Beneficiary, and Others Named as Contingent Beneficiaries | | Designation of Beneficiary Consented to by Wife | | Right to Change Beneficiary or Surrender Policy Retained by Husband | |
|---|---|---|---|---|---|
| Number of Policies | Name of Insurer | Yes | No | Yes | No |
| 1 | Pacific Mutual | | X | X | |
| 1 | Aetna | | X | X | |
| 8 | Equitable | X | | X | |
| 2 | Travelers | X | | X | |
| 1 | Massachusetts Mutual | X | | X | |
| 2 | Mutual of New York* | | X | X | |
| 2 | Equitable | X | | X | |
| 3 | New York Life | X | | | X |
| 1 | John Hancock | X | | | X |
| 2 | Aetna | | X | X | |

*Could not take cash surrender value.

| Policies Under Which Daughter or Grandchildren Were Named Primary Beneficiaries, and Wife Named as Contingent Beneficiary | | Designation of Beneficiary Consented to by Wife | | Right to Change Beneficiary or Surrender Policy Retained by Husband | |
|---|---|---|---|---|---|
| Number of Policies | Name of Insurer | Yes | No | Yes | No |
| 2 | Mutual Benefit | | X | X | |
| 1 | West Coast | | X | X | |

The Government's postion on this issue has been that Mrs. Stewart's community property interest in these policies was includible in her gross estate under Sec. 811(a), (c) or (d) of the Internal Revenue Code of 1939 (R. 45).

The District Court concluded that her interest in the policies was in effect only a right of protection; that is, a right during her lifetime to object in the event more than half the proceeds were paid to a stranger on Mr. Stewart's death without her consent (R. 48, 49). The Court held that this right was extinguished when she predeceased her husband and that, however such a right might be classified, there

was no taxable transfer of the right on her death, and there was therefore no basis for including a value for these policies in the wife's taxable estate (R. 46, 47, 49).

On appeal by the Government, the Court of Appeals reversed this decision of the Court below and held that one-half the cash value of all the policies was subject to the federal estate tax in the estate of Mrs. Stewart (R. 76, 77). This taxability was apparently based on Sec. 811(a)[1] and was founded on the Court's belief "that a substantial interest passed from the wife to the husband upon the wife's death with respect to all of the policies" (R. 76).

The taxpayer petitioned the Court of Appeals for a rehearing on this issue, citing the recent decision of the Superior Court of the State of California in and for the County of San Diego in *Estate of Mendenhall*, (Appendix, pp. 31-48), which decided the identical issue, in the context of the California inheritance tax, in favor of the taxpayer. The taxpayer here advised the Court that the *Mendenhall* case was in the process of being appealed by the State Controller, and urged the Court to defer its final decision in the instant case until after the California Appellate Court had reviewed the *Mendenhall* decision. It was recognized that the federal estate tax and the California inheritance tax are not in all respects iden-

[1]The Court of Appeals also indicated a belief that one of the policies would also be taxable under Sec. 811(c)(1)(B)(i), relating to transfers with retained life estates (R. 75, 76).

tical, but it was submitted that the appellate decision in *Mendenhall* will be the first and only California appellate authority defining the rights at death of a California wife in community insurance policies on the life of her surviving husband; it was urged on behalf of the taxpayer that such authority under the local property and inheritance tax law would then be directly applicable to the federal estate tax issue, pursuant to the decision in *U. S. v. Waechter*, (CA-9), 195 F.2d 963, which had affirmed a District Court decision for the taxpayer on this exact issue, based on a decision under the inheritance tax law of the State of Washington.

The Court of Appeals rejected the contentions of the taxpayer and denied his petition for a rehearing (R. 82). In its opinion on rehearing (R. 80-82), the Court stated that it saw no reason for deferring decision pending review in the *Mendenhall* matter, since it found nothing in the *Mendenhall* decision which would affect the case at bar (R. 82), and that it was the recognition that the husband's interests in the policies were expanded or "improved" by reason of the death of the wife that warranted the inclusion of the policies in her gross estate.

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**REASONS FOR GRANTING THE WRIT.**

The decision of the Court of Appeals should be reviewed because (1) to the extent that it considers its decision unaffected by the result in the *Mendenhall*

case, the Court of Appeals has reached a decision ". . . in conflict with applicable state . . . law"; and (2) it has ". . . decided an important question of federal law which has not been, but which should be settled by this Court . . .". Rule of the Supreme Court 19.

1. The decision of the trial Court in *Estate of Mendenhall,* San Diego Superior Court No. 56225 (Appendix, pp. 31-48), is that the interest of a deceased wife in the cash value of community insurance policies on the life of her surviving husband, whatever such interest may be, *does not pass by will or inheritance* in California, and it is therefore not subject to the California inheritance tax. Granting the distinction between an estate tax and an inheritance tax which has been so emphasized by the Court of Appeals (R. 72, 80-82), it still remains clear that there must be a "*transfer* of a net estate" to incur the federal estate tax. Internal Revenue Code of 1939, Sec. 810. And if the wife's interest in insurance policies or her husband's life cannot be transferred by her will or by the laws of succession under local substantive law, how is the transfer of that part of her net estate, if such it is, achieved?

The Court of Appeals, in denying the taxpayer's petition for rehearing, relied upon its belief that the surviving husband's "position has been improved", since he could surrender the policies after his wife's death and retain the cash proceeds as his own. The Court then characterized this "improvement of position" as a taxable transfer of an estate (R. 82).

It is the position of taxpayer that the mere improvement of financial position of one person on the death of another is not of itself sufficient to constitute a taxable transfer under the federal estate tax law. For example, there is no question but that there is no tax upon the estate of a life tenant by reason of the termination of the life tenancy, notwithstanding that the interest of the remainderman is enhanced and his "position is improved" on the death of the life tenant.[2] A similar situation exists in the case of joint tenancies, with respect to which a specific section in the law was considered essential to impose the estate tax.[3]

The decision of the Court below can be interpreted in only one of two ways: (1) It either ignores the applicable state law, or (2) It holds that Sec. *811(a)* requires the imposition of an estate tax on property over which the decedent has no power of testamentary disposition and which cannot be inherited from her by intestate succession. It is submitted that there is no precedent for such a holding, that when the Congress has desired to tax certain transfers other than by will or succession, it has enacted specific sections in the Internal Revenue Code to accomplish such taxation,[4] that the so-called "transfer" now before the

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[2] *Rhodes v. Comm.*, 41 B.T.A. 62, aff'd (CA-8, 1941), 117 Fed. 2d 509.

[3] Internal Revenue Code of 1939, Sec. 811(e); see Beveridge, *Law of Federal Estate Taxation* (Callaghan & Co., 1956), Sec. 4.02, p. 129.

[4] 1939 Internal Revenue Code Sections 811(b) through (g); 1954 Internal Revenue Code Sections 2034 through 2042.

Court has not been shown includible in any one of these specific sections, and that it is therefore not subject to the federal estate tax which was in force at the time of this decedent's death.

2. It is respectfully submitted, further, that the issue now before this Court constitutes an important question of federal law which should be settled by this Court. The impact of the Court of Appeals' decision upon estate planning and protection in all the community property states and the reliance upon insurance as a form of liquid asset which would be available for payment of death taxes, is most disturbing. It is important that the proper interpretation of the law be settled by a decision of this Court. The only federal appellate decisions on this issue are the instant decision of the Court of Appeals for the Ninth Circuit and the previous decision of the same Court in *Waechter v. U. S., supra.* It is believed that these decisions of the same Court are in conflict, notwithstanding that the latter is concerned with the community property state of Washington while the former involves the community property state of California. At a minimum, these two decisions can furnish no sound basis for a consistent administration of the federal estate tax law on a subject matter of extreme importance; and the need for such a consistency is clearly indicated by the quantity of life insurance in force in the ten community property states in the United States.

## CONCLUSION.

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Dated, San Francisco, California,
December 11, 1959.

Respectfully submitted,

GEORGE H. KOSTER,
*Attorney for Petitioner.*

RICHARD W. GRAHAM,
*Of Counsel.*

**(Appendices A, B, C, D and E Follow.)**

## Appendix A

United States Court of Appeals
for the Ninth Circuit

| | |
|---|---|
| United States of America,<br>Appellant,<br>vs.<br>Ashby O. Stewart, Executor of the Last Will and Testament of Mary W. Stewart, Deceased,<br>Appellee. | No. 16,014<br>June 18, 1959 |

Appeal from the United States District Court
for the Northern District of California.

Before: DENMAN, Senior Circuit Judge,
POPE, Circuit Judge, and
JAMESON, District Judge.

JAMESON, District Judge:

Plaintiff seeks recovery of federal estate taxes paid on decedent's interest in certain life insurance and annuity policies.

Ashby and Mary Stewart were married in 1906 and their marital relationship continued until Mary's death on February 21, 1951. They were residents of California. At the time of the wife's death there were

26 insurance and annuity policies on the life of the husband, and seven annuity policies naming the wife as annuitant. The premiums on all of the policies were paid with community property funds.

Two questions are presented (1) whether one-half of the cash value of the 26 policies on the life of the husband was properly includable in the wife's gross estate; and (2) whether all, or one-half, of the proceeds of five of the annuity policies in the name of the wife should be included.[1]

## POLICIES ON HUSBAND'S LIFE

The Government contends that under the California law the decedent had a vested ownership interest of one-half of the cash value of the 26 policies on her husband's life, and that the policies are accordingly includable under Section 811(a), Int. Rev. Code of 1939[2] to the extent of her interest, and if not includable under §811(a), her interest is includable under either §811(c)(1)(C) as a transfer intended to take effect in possession or enjoyment after her death or under §811(d) as a revocable transfer.

Appellee contends that decedent's community interest in the insurance policies was merely the right to

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[1]No question has been raised on appeal with respect to two of the annuity policies, which the district court found to be separate property of the wife.

[2]§811(a) Int. Rev. Code of 1939 provides: "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—(a) to the extent of the interest therein of the decedent at the time of his death; . . ."

object to a payment of the proceeds to a third party beneficiary or to secure the proceeds where she was named beneficiary, both of which rights were contingent upon her surviving her husband; and that when she died before her husband these community property rights of protection died with her and were extinguished.

In determining whether one-half of the cash surrender value of these policies was includable in decedent's gross estate, three questions are presented with respect to each of the 26 policies: (1) Was the policy community property under California law at the time of decedent's death? (2) If so, what was the nature and extent of the decedent's interests in the policy under California law? (3) Were these interests of such a nature as to require the inclusion of any amount attributable to them in the decedent's estate for purposes of the federal tax?

The question of whether the interest of the wife in her husband's life insurance policies is includable in her estate for tax purposes is determined by the state law of community property. Poe v. Seaborn, 1930, 282 U.S. 101, 51 S. Ct. 58, 75 L. Ed. 239; Lang v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 82 L. Ed. 1331. Under California law, where policies are taken upon the husband's life during coverture and premiums are paid from community funds, the policies are community property. New York Life Ins. Co. v. Bank of Italy, 1923, 60 Cal. App. 602, 214 P. 61; In Re Castagnola's Estate, 1924, 68 Cal. App. 732, 230 P. 188.

The respective interests of the husband and wife in community property "are present, existing and equal interests * * *". Cal. Civ. Code §161(a). The husband retains possession and control of the community property. Cal. Civ. Code §172. "Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent and, in the absence thereof, goes to the surviving spouse * * *". Cal. Prob. Code, §201.

While life insurance, because of its hybrid nature, is necessarily accorded individualistic treatment in the law generally, this fact has apparently not been regarded by the California courts as requiring that it be treated *sui generis* for the purposes of the community property laws. We find nothing in California law which indicates that life policies as items of community property are treated by rules other than or different from those pertaining to community property generally. See California Trust Company v. Riddell, S. D. Calif. 1955, 136 F. Supp. 7, and Thurman, Fed. Estate & Gift Taxation of Community Property Life Insurance, 9 Stan. L. Rev. 239, (1957).

In Dixon Lumber Co. v. Peacock, 1933, 217 Cal. 415, 19 P. 2d 233, a wife's interest in insurance policies on her husband's life purchased with community property funds was held to be a "valuable property right", the relinquishment of which was valid consideration for an assignment by the husband to her of a mortgage.

The trial court held that all of the policies were community property, and appellee does not contend otherwise. Since all premiums were paid with community funds, this conclusion is clearly correct, unless the wife subsequently released her interest, converting it into separate property of the husband. The determination of the question of taxability depends upon whether the wife so released her interest. Whether the wife released her interest depends not alone upon whether she consented to the designation of beneficiaries, but also upon the incidents of ownership retained by the insured in the respective policies. "(I)t may be said in general that incidents of ownership mean any power over an insurance policy which amounts to substantial ownership of the policy, such as the power to change the beneficiaries of the policy, to surrender the policy for its cash surrender value, to borrow against the policy, etc."[3]

The district court in holding that no part of the value of the insurance policies was includable in the wife's estate stated that the wife's interest was merely "a right of protection" which "did not inure to the benefit of anyone on her death since her death extinguished this right" and that "(b)oth before and after her death he had the right to take the cash surrender value of these policies without her consent, because he had the management and control of the community property." We are unable to agree that

[3] Lowndes and Kramer, Federal Estate and Gift Taxes, p. 275. See also Commissioner of Int. Rev. v. Chase Manhattan Bank, 5 Cir. 1958, 259 F. 2d 231, 245-246.

the wife's interest in the policies amounted to no more than "a right of protection". It is conceivable that under state law a thing could be termed "community property" and yet the wife's real interests in the thing be so insubstantial that nothing attributable to them could be included in her estate for federal tax purposes. Cf. Talcott v. United States, 9 Cir. 1928, 23 F. 2d 897. The able trial judge used just such a rationale. His conclusion, however, overlooks the fact that if the husband took the cash surrender value before the wife's death, it would remain community property in which she had a one-half interest, but if he took the cash surrender value after her death he would be the sole owner. In other words, the right to one-half of the cash value of the policies passed to the husband upon the death of the wife.

In California Trust Company v. Riddell, supra, holding that the decedent's wife had an interest in her husband's life insurance policies, which should have been included in her gross estate, the court said in part: "She has such an interest in community property that it is possible for her to will away her portion thereof and thus, at her death, cause a division of the community estate. Probate Code §202. The fact that the policies in question were retained by the husband and that he had a right to change beneficiaries at will does not mean he could deprive the wife of her community interest therein without her consent." 136 F. Supp. at 9.

The trial judge, in his opinion, (158 F. Supp. 25) refers to two cases where the point here involved is considered, i.e., California Trust Company v. Riddell, supra, and Waechter v. United States, W.D. Wash. 1951, 98 F. Supp. 960; affirmed 1952, 195 F. 2d 963. The judge was more persuaded by the reasoning in the Waechter case and by the fact that the decision was upheld by the Court of Appeals.

Prior to the Waechter case the Supreme Court of Washington in In Re Knight's Estate, 1948, 31 Wash. 2d 813, 199 P. 2d 89, had held that no part of the cash surrender value of insurance policies on the life of a husband, the premiums for which were paid out of community property, is includable in the estate of the wife when she predeceases her husband under the Washington inheritance tax statutes. The trial court in the Waechter case relied upon the Knight case as binding in the interpretation of Washington law. Since the decision of the trial court in this case, however, the Supreme Court of Washington has expressly overruled In re Knight, saying in part: "* * * (W)e are constrained to hold that our decision in In re Knight's Estate, supra, was incorrect in holding that the cash surrender value of a life insurance policy is not property 'which passes by will or by the statute of inheritance.' In our opinion, the state in this case is taxing the receipt by Mrs. Leuthold's legatees, pursuant to her will, of her one-half interest in the cash values of these policies . . . and that under the provisions of RWC 83.04.010, it is entitled to do so." In

re Leuthold's Estate, 1958, 50 Wash. 2d 869, 324 P. 2d 1103, 1109.[4]

It should be noted also that both the Washington and California statutes impose an inheritance tax upon the property which passes either by will or by the statutes of inheritance. Section 811(a) includes in the gross estate for federal estate tax purposes property "to the extent of the interest therein of the decedent at the time of his death." An inheritance tax is an "excise or impost laid upon the privilege of receiving property by inheritance." In re Knight's Estate, supra. An estate tax is levied upon the privilege of transfer of property at death. "It does not tax the interest to which the legatees and devisees succeed on death, but the interest which ceased by reason of death; what is imposed is an excise upon the transfer of an estate upon death of the owner." Commissioner of Internal Revenue v. Clise, 9 Cir. 1941, 122 F. 2d 998, 1001, and cases cited therein.[5]

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[4]Accord: Thompson v. Calvert, Tex. Civ.App. 1957, 301 S.W. 2d 496; Estate of Louisa Morris Carroll v. Commissioner of Internal Revenue, 1933, 29 B.T.A. 11 (Louisiana residents). See also Commissioner of Int. Rev. v. Chase Manhattan Bank, 5 Cir. 1958, 259 F. 2d 231.

It is important to note that In re Leuthold was decided May 2, 1958, subsequent to the opinion of the trial court in this case.

[5]The distinction between the California Inheritance tax law and federal estate tax law was set forth by the California Superior Court for the County of San Diego in a recent unreported decision in Estate of Mendenhall, No. 56225. While the court held that the California inheritance tax statute did not cover any interest in insurance policies on the life of a husband, where the wife predeceased the husband (relying in part upon In re Knight and the dissenting opinion in Estate of Leuthold), the opinion recognized "that there is a distinct difference between an estate tax and an inheritance tax", quoting from 26 Cal. Jur. 2d at p.

We come now to an analysis of the various policies to determine whether a substantial interest therein passed from the wife to the husband upon the wife's death.

With respect to seven[6] of the 26 policies, the husband retained the right to change the beneficiaries and to obtain the cash value, and the wife did not consent to the designation of beneficiaries. These policies are clearly includable in the wife's gross estate for tax purposes.

In thirteen polices,[7] the husband retained the right to change beneficiaries, and to obtain the cash value, but the wife endorsed the designation of beneficiaries or mode of settlement. It has been held that under California law a wife surrendered her community property interests in the proceeds of a policy on her husband's life by endorsing her consent to the designation of a beneficiary other than herself. Ettlinger

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691. §13553 of the California Revenue and Taxation Code expressly provides that the community interest which goes to a surviving husband pursuant to Section 201 of the Probate Code is not subject to inheritance tax. It is apparent accordingly that the outcome of any appeal in the Mendenhall case would not affect our decision in this case.

[6]Pacific Mutual Life Insurance Company Policy No. 336749, (Ex. J); Aetna Life Insurance Company Policy No. 530811, (Ex. L); Mutual Benefit Life Insurance Company Policies No. 838189 and 838190 (Ex. R); West Coast Life Insurance Company Policy No. 97457, (Ex. S); and Aetna Life Insurance Company Policies No. 778050 and 778051 (Ex. T).

[7]Equitable Life Assurance Society Policies No. 2,370,306; 1,926,371; 1,926,372; 2,249,133; 2,387,397; 2,387,396; 2,387,398; 2,796,071 (Ex. H); Travelers Insurance Company Policies No. 409014 and 409015 (Ex. I); Massachusetts Mutual Life Insurance Company Policy No. 459078 (Ex. K), and Equitable Life Assurance Society Policies No. 9,577,484, and 9,577,482 (Ex. M).

v. Conneticut General Life Ins. Co., 9 Cir. 1949, 175 F. 2d 870. It has also been held where the wife was designated primary beneficiary and the insured's mother final beneficiary under a community policy on the husband's life, that by consenting to the designation the wife had released her community interests in the proceeds of the policy in consideration for having received the right to the entire proceeds should she survive the insured and the period over which the proceeds were to be paid. Mayr v. Arana, 1955, 133 Cal. App. 2d 471, 284 P. 2d 21.

Both the Ettlinger case and the Mayr case, however, were concerned with the right to the proceeds of the policies after the death of the insured. Here we are concerned with the rights in the policies themselves during the existence of the community. It is important to recognize this distinction in determining what rights were retained by the wife in the community assets.[8] Under California law the husband has the power of management and control over insurance policies on his life, although he cannot give them away without the written consent of his wife. Cal. Civ. Code §172. In the event that the husband dies before the wife, she has the right to object to the proceeds of the policies going to a third person to the extent of her one-half interest therein. New York

[8] In Commissioner v. Chase Manhattan Bank, 5 Cir. 1958, 259 F. 2d 231, the court said that "there is a discoverable touchstone for applying orthodox community principles to insurance. The touchstone is the distinction between *policy-rights* and *proceeds-rights*." 259 F. 2d at 245. See also Thurman, Federal Estate and Gift Taxation of Community Property Insurance, 9 Stan. L. Rev. 239 (1957).

Life Ins. Co. v. Bank of Italy, 1922, 60 Cal. App. 602, 214 P. 61. However, if the wife take no steps in her lifetime to invalidate a gift of community property by her husband, the gift to the designated beneficiaries becomes valid. Mayr v. Arana, supra.

It was in view of these rules that the court in Mayr v. Arana said: "There was not a gift of the proceeds of the policy to (the husband's mother) since the decedent (husband) could have given one-half of the proceeds to his mother without his wife's consent, but in consideration of the wife's consenting to the policy whereby she became the primary beneficiary of the entire amount named in the policy she released her community interest, in the event of her death prior to her mother-in-law's, to (her mother-in-law)." 284 P. 2d at 25. It way well be true that had the husband predeceased the wife in the instant case, her consent to the designation of the beneficiaries would have precluded her from contesting such designation after death of her husband, but such a rule should not be extended to the present situation. Where the husband retains both the right to obtain the cash value and the right to change beneficiaries, the wife cannot be held to have intended by her endorsement to surrender her community interest in the policies.

Moreover, where the insured designates a beneficiary but retains the right to change the designation, the interests of the beneficiaries prior to the death of the insured is that of a "mere expectancy of an incompleted gift." In re Castagnola's Estate, 1924, 68 Cal. App. 732, 230 P. 188, 190. Or, as stated in

Travelers' Ins. Co. of Hartford, Conn. v. Fancher, Calif. 1933, 219 Cal. 351, 26 P. 2d 482, 483, "the designation of a beneficiary in a policy of life insurance initiates in favor of the beneficiary an inchoate gift of the proceeds of the policy, which, if not revoked by the insured prior to his death, vests in the beneficiary at the time of his death." Thus, the wife's endorsement of the designation of beneficiaries was at most an assent to an incompleted gift, which was still incompleted at the time of her death. It was not a transfer to her husband. We hold therefore that the wife's interest in these 13 policies in includable in the wife's gross estate for tax purposes.

With respect to two annuity policies,[9] the wife made no endorsement, and the husband retained the right to change beneficiaries but he relinquished the right to obtain the value in cash. He did, however, retain the right to alter the mode of settlement and to elect to have the policy mature; i.e., to begin to receive monthly installments, at an earlier date. In other words, the policies remained a valuable asset of the community and one-half of their value should be taxed to the wife's estate.

Four annuity policies had matured at the time of the wife's death,[10] and pursuant to the settlement agreements the value of the policies was to be paid in

[9] Mutual Life Insurance Company of New York Policies No. 225197 and 225198 (Ex. N).

[10] New York Life Insurance Company Policy No. 123,101 (Ex. O); New York Life Insurance Company Policies No. 123,837 and 123,838 (Ex. P) and Hancock Mutual Life Insurance Company Policy No. 020695 (Ex. Q).

240 equal monthly installments. The husband was named as annuitant or first beneficiary, the wife the second, and others were named as subsequent beneficiaries. With respect to three of the policies,[11] the wife had consented to earlier settlement agreements which were revoked by the husband prior to his execution of the settlement agreement in effect when the wife died. (These transactions illustrate how illusory the wife's interest in the policies would be if it were held that by consenting to a revokable designation of beneficiaries, she surrendered her interest in the community property.) The wife did not sign the settlement agreements which were in effect at her death. Therefore, the wife's interest in these three policies must be included in her gross estate.

The wife did sign the fourth of the annuity contracts, issued by John Hancock Mutual Life Insurance Company. In effect the joinder of the husband and wife in this settlement agreement constituted a transfer by the community under which the community retained for its life, or the life of the survivor, the right to income from the property. In our opinion, this policy is includable under Section 811(c)(1)(B)(i), which provides: "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . . (c)(1) To the extent of any interest therein of which the decedent has at any time made a transfer . . . (B) under which he has retained for his life . . . (i) the

[11]The three New York Life Insurance Company contracts.

possession or enjoyment of, or the right to income from, the property . . ."

In any event, the wife's endorsement did not in our opinion constitute a surrender of her interest in the policy. Such a holding would mean that the payments coming to the husband under this contract would be his separate property rather than community property. We cannot presume that the wife so intended. Nor does the Ettlinger case[12] compel a contrary conclusion. It is one thing to hold that a wife's consent to a beneficiary designation on an insurance policy on the husband's life means that she gave up her interest in the proceeds of the policy after her husband's death. It is quite another to say that the husband and wife are making a gift of their community interests in an annuity contract when they join in a settlement agreement which has the effect of insuring that the community, or the survivor thereof, will receive the annuity payments as long as either is alive.

In fact the language of the Mayr[13] case quoted above ("There was not a gift of the proceeds of the policy to (the husband's mother) since the decedent (husband) could have given one half of the proceeds to his mother without his wife's consent . . .") militates against the conclusion that the husband made a gift of his interest in the annuities.[14]

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[12]Ettlinger v. Connecticut General Life Ins. Co., 9 Cir. 1949, 175 F. 2d 870.

[13]Mayr v. Arana, 1955, 133 Cal. App. 2d 471, 284 P. 2d 21.

[14]If the replacement value of the Hancock policy is not includable under § 811(c)(1)(B)(i), then it is includable under § 811(a), since the wife's signature on the settlement agreement

We find accordingly that a substantial interest passed from the wife to the husband upon the wife's death with respect to all of the policies. Since we can find no warrant in California law for treating life insurance as a community asset differently from other kinds of property, we hold that at the time of the wife's death she had present, existing and equal interests with her husband in the policies; that these interests amounted to ownership of one-half of whatever value the policies had at the time of her death, and that such an amount must be included in her gross estate.[15]

## ANNUITY POLICIES ISSUED TO WIFE

The trial court found that the husband had relinquished his community property rights in two policies,[16] and that they were the separate property of Mrs. Stewart at the time of her death. No appeal was taken from this ruling. With respect to the five remaining policies[17] the trial court found that they were community property at the time of Mrs. Stewart's death and that one-half of the cash surrender value

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did not, in our opinion, evidence a surrender of her community interest in the policy.

[15]This is a logical result, since it is clear that upon the death of a husband, with a wife surviving, only one-half of the proceeds of his life insurance, purchased with community funds, is includable in his estate. Lang v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 82 L. Ed. 1331.

[16]Fidelity Mutual Life Insurance Company Policies No. 521822 and 521823 (Ex. C).

[17]John Hancock Mutual Life Insurance Company Policies No. 0128280 and 0128263 (Ex. D); Aetna Life Insurance Company Policies No. AP 1849 and AP 1850 (Ex. E); and Equitable Life Assurance Society Policy No. 9685846 (Ex. F).

accordingly was includable in her gross estate. In our opinion there is sufficient evidence to support the trial court's findings. See opinion at 158 F. Supp. 25.

The judgment is affirmed with respect to the policies issued to the decedent and reversed with respect to the policies issued to her husband and remanded for recomputation of the tax in conformity with this opinion.

(Judge Denman did not participate in this opinion).

(Endorsed:) Opinion. Filed June 18, 1959.

Paul P. O'Brien, Clerk.

## Appendix B

United States Court of Appeals
for the Ninth Circuit

| | |
|---|---|
| United States of America, Appellant, vs. Ashby O. Stewart, Executor of the Last Will and Testament of Mary W. Stewart, Deceased, Appellee. | No. 16,014 |

### JUDGMENT

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is affirmed with respect to the policies issued to the decedent and reversed with respect to the policies issued to the husband, and that this cause be, and hereby is remanded to the said District Court for recomputation

of the tax in conformity with the opinion of this Court.

(Endorsed:) Judgment.
Filed and entered: June 18, 1959.
Paul P. O'Brien, Clerk.

## Appendix C

United States Court of Appeals
For the Ninth Circuit

| | |
|---|---|
| United States of America, Appellant, vs. Ashby O. Stewart, Executor of the Last Will and Testament of Mary W. Stewart, Deceased, Appellee. | No. 16,014 Sept. 28, 1959 |

On Petition by Appellee for Rehearing

Before: POPE, Circuit Judge, and JAMESON, District Judge.

Per Curiam:

Appellee has filed a petition for rehearing and has requested that action thereon be deferred until Estate of Mendenhall, decided by the Superior Court of the State of California, in and for the County of San Diego, has been reviewed by the appellate court. In our opinion we stated that the outcome of any appeal in the Mendenhall case would not affect our decision. Is that conclusion justified?

Pursuant to § 811(a) Internal Revenue Code of 1939, the value of the gross estate of the decedent for federal estate tax purposes is determined by including

the value of all property (except real property outside of the United States) "to the extent of the interest therein of the decedent at the time of his death * * *." Testamentary disposition is not required, and the tax is not imposed upon the right of receiving property by inheritance. On the other hand, the state inheritance tax of California is imposed "either on the transmission or the exercise of the legal power of transmission of property by will or descent, or on the legal privilege of taking property by will or descent."[1]

The Mendenhall decision emphasizes many times the distinction between the federal estate tax and state inheritance tax. The basis for holding that the wife's interest in her husband's insurance policies was not subject to inheritance tax was summarized as follows: "It is the Court's view that no interest in the cash surrender value of the insurance policies involved in this case passed by will or inheritance; that a tax imposed on Mrs. Mendenhall's legatees, based on the assumption that something of value passed to them, is completely unjustified; that the interest therein received by Mr. Mendenhall was by reason of the contract of insurance. The Court does not deny that Mr. Mendenhall's position has been improved. The Court does, however, deny that the California inheritance tax statute covers such an interest as he has received, and whether it does or does not, should be the prime issue in this case. * * *"

[1]See article dealing with inheritance and gift taxes in 26 Cal Jur. 2d at page 691, quoted in the Mendenhall decision.

Judge Thomas, in his opinion in the Mendenhall case, found the reasoning of Chief Justice Hill in his dissenting opinion in the Leuthold case[2] "most cogent and most persuasive". A portion of Chief Justice Hill's opinion, quoted in the Mendenhall decision, points up even more precisely the distinction between the federal estate tax and state inheritance tax. The Washington court had held in the Knight case[3] that no part of the tax surrender value of the husband's life insurance policies was includable in the wife' estate, and this holding was expressly overruled by the majority opinion in the Leuthold case. Chief Justice Hill had participated in the Knight case. In his dissenting opinion in the Leuthold case, he said in part:

> "The fact * * * is that, insofar as the cash surrender value of these insurance policies is concerned, the only person who has received any benefit is Mr. Leuthold, and he has received it not because he was a legatee or an heir, but because of the nature of the contract of insurance."
>
> * * *
>
> "The Knight case did not hold that a wife had no community interest in the cash surrender value of life insurance policies. It held, and I believe properly, that the interest, whatever its character, did not pass by will or by the statute of inheritance; but that it passed to her husband by the contract of insurance; and there is nothing in our inheritance tax law that made such a transfer of interest taxable."

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[2]In re Leuthold Estate, 1958, 52 Wash. 2d 250, 324 P.2d 1103.

[3]In re Knight's Estate, 1948, 31 Wash. 2d 813, 199 P.2d 89.

Appellee's petition for rehearing relies strongly upon the opinion of the trial judge in the Waechter case,[4] which in turn was predicated largely upon the holding of the Washington Court in the Knight case. The decedent in the Waechter case died when the Revenue Act of 1942 was in effect. Section 811(e)(2) relating to community interest contained the following provision: "In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition." The community property provisions of the 1942 Act were repealed by Section 351 of the Revenue Act of 1948, c. 168, 62 Stat. 110, effective with respect to estates of decedent dying after December 31, 1947. The decedent in this case died in 1951. Any requirement of testamentary disposition under the 1942 Act accordingly would not be applicable in this case.

We find nothing in the Mendenhall decision or other California cases to justify a conclusion that the decedent did not have a property interest in her husband's insurance policies at the time of her death. This interest was taxable as a transfer to her husband. In other words, there was a transfer to the husband within the meaning of Section 810 of the Internal Revenue Code of 1939, even though it was not effected by will or inheritance.[5]

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[4]Waechter v. United States, W.D. Wash. 1951, 98 F.Supp. 960.

[5]Both the Mendenhall opinion and the dissenting opinion in the Leuthold case expressly recognize that the husband's "position has been improved", without calling the change in position a "transfer". Both of these opinions, however, were concerned with a transfer by will or inheritance.

We see no reason accordingly for deferring action on appellee's petition for rehearing pending appellate review of Estate of Mendenhall. The petition for rehearing is denied.

(Endorsed:) Per Curiam Opinion on Petition for Rehearing. Filed Sep. 28, 1959.

Paul P. O'Brien, Clerk.

## Appendix D

Civil Code of California:

Sec. 161a. *Community property; interests of parties defined.*

The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property (Added Stats. 1927, c. 265, p. 484, Sec. 1.)

Sec. 164. *Community property; presumptions as to property acquired by wife; limitation of actions.*

All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this State, is community property; but whenever any real or personal property, or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property, and if acquired by such married woman and any other person the presumption is that she takes the part acquired by her, as tenant in common, unless a different intention is ex-

pressed in the instrument; except, that when any of such property is acquired by husband and wife by an instrument in which they are described as husband and wife, unless a different intention is expressed in the instrument, the presumption is that such property is the community property of said husband and wife. The presumptions in this section mentioned are conclusive in favor of any person dealing in good faith and for a valuable consideration with such married woman or her legal representatives or successors in interest, and regardless of any change in her marital status after acquisition of said property.

* * * (Enacted 1872. As amended Stats. 1889, c. 249, p. 328, Sec. 1; Stats. 1893, c. 62, p. 71, Sec. 1; Stats. 1897, c. 72, p. 63, Sec. 1; Stats. 1917, c. 581, p. 827, Sec. 1; Stats. 1923, c. 360, p. 746, Sec. 1; Stats. 1927, c. 487, p. 826, Sec. 1; Stats. 1935, c. 707, p. 1912, Sec. 1; Stats. 1941, c. 455, p. 1752, Sec. 1.)

Sec. 172. *Community personal property; management and control; restrictions on disposition.*

The husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community personal property, or dispose of the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife. (Enacted 1872. As amended Stats. 1891, c. 220,

p. 425, Sec. 1; Stats. 1901, c. 190, p. 598, Sec. 1; Stats. 1917, c. 583, p. 829, Sec. 1.)

Probate Code of California:

Sec. 201. *Title of surviving spouse; portion subject to testamentary disposition or succession.*

Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse subject to the provisions of sections 202 and 203 of this code. (Stats. 1931, c. 281, p. 595, Sec. 201, as amended Stats. 1935, c. 831, p. 2249, Sec. 2.)

Internal Revenue Code of 1939

Sec. 810. *Rate of Tax.*

A tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 812) shall be imposed upon the transfer of the net estate of every decedent, citizen or resident of the United States, dying after the date of the enactment of this title. . . .

Sec. 811. *Gross Estate.*

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

(a) Decedent's Interest.—To the extent of the interest therein of the decedent at the time of his death:

* * *

(c) Transfers in Contemplation of, or Taking Effect at, Death.—

(1) General Rule.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(A) in contemplation of his death; or

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

(2) Transfers Taking Effect at Death.—Transfers prior to October 8, 1949.—An interest in property of which the decedent made a transfer, on or about October 7, 1949, intended to take effect in possession or enjoyment at or after his death shall not be included in his gross estate under paragraph (1) (C) of this subsection unless the decedent has retained a reversionary interest in the property, arising by the express terms of the instrument of transfer and not by operation of law, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 per centum of the value of such prop-

erty. For the purpose of this paragraph, the term "reversionary interest" includes a possibility that property transferred by the decedent (A) may return to him or his estate, or (B) may be subject to a power of disposition by him, but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of evaluation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Commissioner with the approval of the Secretary.

In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate.

(3) Transfers Taking Effect at Death—Transfers After October 7, 1949.—An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate under paragraph (1)(C) of this subsection (whether or not the decedent retained any right or interest in the property transferred) if and only if—

(A) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; or

(B) under alternative contingencies provided by the terms of the transfer, possession or enjoy-

ment of the property can, through ownership of such interest, be obtained only by surviving the earlier to occur of (i) the decedent's death or (ii) some other event; and such other event did not in fact occur during the decedent's life.

Notwithstanding the foregoing sentence, an interest so transferred shall not be included in the decedent's gross estate under paragraph (1)(C) of this subsection if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a power of appointment (as defined in Section 811(f)(2)) which in fact was exercisable immediately prior to the decedent's death.

(d) Revocable Transfers.—

(1) Transfers after June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedents' death;

(2) Transfers on or Prior to June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or

otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includable under this paragraph;

(3) Date of Existence of Power.—For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

* * *

(26 U.S.C., 1952 ed., Secs. 810, 811)

## Appendix E

The Superior Court
County of San Diego
Courthouse
San Diego 1, California
Gerald C. Thomas, Judge

April 6, 1959

James W. Hickey
Walter H. Miller
William L. Baugh
Attorneys for State Controller
520 Rowan Building
458 S. Spring Street
Los Angeles 13, California

OPINION

Winston Churchill Black
Attorney at Law
1306 Mills Tower
San Francisco 4, California

Re: Superior Court No. 56225,
*Estate of Mendenhall.*

Gentlemen:

Hearing was had before the undersigned Judge of the Superior Court at San Diego on October 28, 1957, upon the objections to the Report of the California Inheritance Appraiser filed in the above-entitled estate matter on October 16, 1957. Both oral and documentary evidence was introduced and the State Controller, Robert C. Kirkwood, was represented by Vincent J. McMahon, his attorney, and the estate of

Mazie O. Mendenhall was represented by its attorney, Winston Churchill Black, and various and sundry oral stipulations having been made in open court between the respective parties, and briefs and memoranda of points and authorities having been duly submitted and considered, the Court now renders its opinion, namely:

It is the opinion of the Court that at the time of her death the testatrix, Mazie O. Mendenhall, had no such interest in the life insurance policies upon the life of her husband, Ernest D. Mendenhall, and written by Equitable Life Assurance Society (being 9) and by Mutual of New York (being 3), as listed in the Report of Inheritance Tax Appraiser Edwin A. Mueller, as would result in a taxable transfer upon her death. Each and all of the policies were payable on the death of the insured to the surviving husband's estate, and all of the premiums paid on said life insurance policies were from community funds of the said Mazie O. Mendenhall and her surviving husband, Ernest D. Mendenhall, over a period in excess of thirty years. The aggregate cash surrender value of said policies on the date of the death of the wife, Mazie O. Mendenhall, was $40,998.00. Under the provisions of the last will and testament of the deceased wife, all of her estate, with the exception of minor legacies, is devised and bequeathed to the American Trust Company in trust, with the surviving husband, Ernest D. Mendenhall, as life beneficiary of the income, and upon his demise, remainder to certain of her heirs. The testatrix died April 20, 1956, being

domiciled in San Diego County, California. The deceased wife was fully aware of the existence of the life insurance policies, of the fact that all premiums were paid by use of community funds and were payable to the estate of her husband, and acquiesced in her husband's estate being beneficiary thereof. The controller's motion to strike evidence of the wife's knowledge in that regard is by the Court denied.

We must never forget, in solving the problem before us, that we are dealing with a state inheritance tax as distinguished from a federal estate tax, and must at all times keep in mind the basic distinctions in these taxes. As is indicated in 26 Cal. Jur. 2d in the article dealing with inheritance and gift taxes, at page 691:

> "The inheritance tax is not a direct tax, but is rather a form of excise imposed primarily either on the transmission or the exercise of the legal power of transmission of property by will or descent, or on the legal privilege of taking property by will or descent. As an excise, the inheritance tax is not subject to constitutional limitations applicable to direct taxes, and may be imposed on the right to succeed to property which itself would be exempt from direct taxation. * * *
>
> "Unlike the federal estate tax, which is a tax on the right of a decedent to transmit property and is measured by the size of the decedent's net estate, the inheritance tax is measured by the share of a decedent's net estate passing to each beneficiary, and the rates vary in accordance with the amount received by each beneficiary and his relationship to the decedent."

Counsel for the respective parties have in their briefs referred from time to time to various decisions involving federal estate tax, and the Court has at all times sought to keep in mind the basic distinctions quoted above.

Another point that must be constantly borne in mind is that the insurance involved is not upon the life of the decedent in whose estate it is sought to have part of the value of the policies included as an asset. The California inheritance tax provided for by sections of the Revenue and Taxation Code of the State of California, and particularly Chapters 1 to 14, inclusive, in part 8 in division 2 thereof, Chapter 1, involves definitions of terms. Section 13401 provides, "An inheritance tax is hereby imposed upon every transfer subject to this part." Chapter 3 deals with the disposition of community property and Section 13553 deals with a situation arising upon the death of a wife. That section provides:

> "Upon the death of a wife the one-half of the community property which belongs to her surviving husband pursuant to Section 201 of the Probate Code is not subject to this part. Likewise, the community interest which goes to a surviving husband pursuant to Section 201 of the Probate Code in the absence of his wife's testamentary disposition of the interest to another, or which passes to him under her will, is not subject to this part."

The passage of any interest of the wife in the life insurance policies upon the life of the husband at the time of her death is not under the provisions of the

Inheritance Tax Act expressly made taxable. There is no dispute in the evidence but that the moneys used to acquire the insurance were community property. It clearly appears from the evidence that the wife was fully aware of the fact that at the time of the issuance of the policies her husband's estate was named as beneficiary and that she was not named as such beneficiary. So long as she lived the policies were permitted to remain in that condition. The decedent was fully aware of the fact that community funds were being used to pay the premiums on the policies. Of these policies nine were issued by the Equitable Life Assurance Society of the United States for a total cash surrender value as of April 20, 1956, the date of decedent's death, of $32,976.16, and three of the policies being issued by Mutual of New York, having a total cash surrender value as of April 20, 1956, in the amount of $8,021.89. In presenting the matter on behalf of petitioners, the surviving husband took the position that no steps to assert her interest in the policies had been taken by the decedent during her lifetime and that her estate had no interest in said policies at the time of her death, and that no taxable transfer took place by reason of her death. On the contrary, the Inheritance Tax Department has taken the position that one-half of the cash surrender value of said policies is an asset belonging to her estate and that the same should be inventoried and included in determining the amount of inheritance tax which became due by reason of her death.

The matter is before the Court on a petition for instructions by the executor of the will and objections

to the Report of the Inheritance Tax Appraiser. Apparently there are no California Supreme or District Court decisions dealing with this legal question. Reference has been made in the briefs to the case of *California Trust Company v. Riddell,* 136 Fed. Supp., page 7, where it was held that on the death of the wife, the wife's community interest in the insurance policies on the life of the husband who was living at the time of her death is subject to federal estate tax. The petitioner, in his brief, quoted the case of *Waechter v. the United States,* 98 Fed. Supp. 906. In that case the Court was dealing with the law of the State of Washington and it was held that on the death of the wife, the wife's community interest in insurance policies on the life of the husband was not subject to federal estate tax. However, the Inheritance Tax Department takes the position that the Waechter case is limited to the situation under the law of Washington and that the Riddell case is strictly proper and applicable under the law of California. In connection with the Waechter case a recent decision is *Estate of Grace H. Leuthold, Deceased,* decided May 2, 1958, by the Supreme Court of Washington, 52 Washington Decisions 250; 324 P. 2d 1103, and under No. 34041 reported in 1958 Prentice-Hall Inheritance and Transfer Tax Services, Recent Decisions and Rulings under issue of June 11, 1958, at paragraph 1011, page 1017. In that case the state attempted to impose an inheritance tax upon one-half of the cash surrender value of six life insurance policies upon the life of the surviving husband of Grace H. Leuthold, who died

testate December 22, 1952. The husband and son were appointed and qualified as executors of her estate. The beneficiaries designated in the several policies at the time of Mrs. Leuthold's death were either the son, daughter or the surviving spouse's estate. All premiums on the policies which became due prior to her death were paid out of community property. The state asserted that her death was a taxable event which passed her half of the community interest in the cash surrender value of the policies to her legatees. The trial court (being bound by the Supreme Court's decision in *In Re Knight's Estate, infra*) was constrained to hold against the state's right to collect the tax in question and the state appealed. After a somewhat lengthy discussion of the problem the Court indicated that there was no doubt that the life insurance policies were community personal property at the time of Mrs. Leuthold's death. All of the incidents of ownership attached to the policies belonged to her and her husband equally. (Citing in support thereof the decisions in *Occidental Life Ins. Co. v. Powers,* 192 Washington 475, 74 Pac. 2d 27 (1937).)

By the majority opinion in the Leuthold case, *supra, Knight's Estate*, 31 Wash. 2d 813, 199 P. 2d 89 (1948), was expressly overruled and the Court reversed the judgment of the trial court and held that judgment should be entered for the amount of the inheritance tax due by reason of the inclusion in the taxable property of Mrs. Leuthold's estate of one-half of the cash surrender value of the six policies described in its original judgment. This decision was by

a divided court, five of the judges joining in the majority opinion and four of the judges dissenting. The reasoning adopted by the dissenting Chief Justice Hill is most cogent and most persuasive and is by this Court adopted. Under inheritance tax laws a tax is imposed, not because somebody dies, but on the right of someone to succeed to the property left by the decedent. Let us then ask, in this instance, who succeeded to the property, i.e. the interest of the decedent in the insurance policies upon her death? The State of California asserts that Mrs. Mendenhall's death was a taxable event which passed her one-half of the community interest in the cash surrender value of the policies to the beneficiaries under her will.

The state, neither in its briefs or arguments, has indicated just how the beneficiaries under Mrs. Mendenhall's will are going to realize anything from her one-half interest in the cash surrender value of the policies.

In the case of a life insurance policy upon the life of the husband there is no provision in the law of the State of California for liquidating any interest which the wife may have had in the property. Granting that the policy had a possible cash surrender value, there is no provision in law for reducing it to the possession or control of the wife's executor. The Court cannot compel the surviving husband to cancel the policy in order that its surrender value might be equally divided between the estate and the husband, and the surrender value remains in the realm of a mere possibility, unless there be power to compel surrender.

In the case of *Stewart v. United States,* 158 Fed. Supp. 25, decided December 18, 1957, it is interesting to note that Judge Hamlin was "more persuaded" by the reasoning of the trial court in the Waechter case than he was by that employed in the case of the *California Trust Company v. Riddell,* cited *supra.* Furthermore, the Waechter case was upheld by the Court of Appeals *(United States v. Waechter* (1952), 195 F. 2d 963). In all three of these cases the Court was concerned with federal estate taxes. Heretofore in my opinion I have sought to make clear that there is a distinct difference between an estate tax and an inheritance tax. Those events which give rise to tax under the California inheritance tax laws are enumerated and specified by the statute itself. Chief Justice Hill, in his dissenting opinion in the Leuthold case, among other things, said:

> "It is my purpose to demonstrate that Mr. Leuthold is the only person who has received the benefit of Mrs. Leuthold's interest in the cash surrender value of the insurance policies; and to demonstrate further that he did not receive it (a) by will, (b) by inheritance, or (c) by a contract made in contemplation of the death of the grantor or donor.
>
> "The fact, unwelcome (to the inheritance tax and escheat division) but indisputable, is that, insofar as the cash surrender value of these insurance policies is concerned, the only person who has received any benefit is Mr. Leuthold, and he has received it not because he was a legatee or an heir, but because of the nature of the contract of insurance."

Continuing in his opinion, Chief Justice Hill said:

> "I do not say that it would not be proper to impose a tax on what he has received, but it is for the legislature to determine whether such a transfer of interest should be taxed, not for the court to impose a tax on such a transfer on what seems to me the completely untenable theory that he has received it by will, or by inheritance.
>
> "The Knight case did not hold that a wife had no community interest in the cash surrender value of life insurance policies. It held, and I believe properly, that the interest, whatever its character, did not pass by will or by the statute of inheritance, but that it passed to her husband by the contract of insurance; and there was nothing in our inheritance tax law that made such a transfer of interest taxable."

In his summation Chief Justice Hill said:

> "I do not deny that Mr. Leuthold's position has been improved. I do deny that the inheritance tax statute covers such an interest as he has received, and whether it does or does not should be the only issue in this case.
>
> "If such an interest should be taxed, the matter can be submitted to the legislature fairly and clearly as a tax on the transfer of the decedent's interest in the cash surrender value of insurance carried on the life of a person other than the decedent.
>
> "* * *
>
> "I would leave legislation to the legislature, particularly the imposition of taxes."

It is interesting that Judges Rosellino and Hunter and Foster concurred with Chief Justice Hill in his view so clearly expressed.

The Court is not unmindful of the case of *Thompson v. Calvert,* 301 S.W. 2d 499, a Texas case decided in 1957. There the Texas inheritance tax included in the estate of Elizabeth Thompson, deceased, one-half of the cash surrender value of policies aggregating $15,138.33 on the life of B. D. Thompson, surviving husband of the decedent. The wife in that instance was the beneficiary in each policy and each policy provided that on her death the two children of the marriage became the beneficiaries. The premiums were paid out of community funds and Thompson had the right at all times to change the beneficiary in each policy. The Court concluded in that instance that the cash surrender value of the insurance policies in question was community property at the time of the decedent's death, and that consequently one-half of such surrender value passed, under the will of the decedent, to her husband, subject to tax. The Court affirmed the judgment of the trial court and permitted the determination of the inheritance tax to stand, even though it clearly held that the inheritance tax, under the law of the state, was a privilege tax and not a property tax, and that the inheritance tax was on the right of succession and not upon the property as such.

There can be no doubt in this matter but that the insurance policies were community property since the premiums were all paid from community funds during the marriage of the insured and his wife,

Mazie O. Mendenhall. (*New York Life Ins. Co. v. Bank of Italy* (1922), 60 Cal. App. 602, 214 P. 61.)

In *Stewart v. United States*—referred to before herein and reported at 158 Federal Supplement at page 25—the United States District Court for the Northern District in its Southern Division, the Court, at page 30 of its opinion, said:

> "There have been only two cases cited to the Court in which the point similar to the one now before the Court has been decided. In California Trust Co. v. Riddell, D.C., Cal. 1955, 136 F. Supp. 7, which was tried in the Southern District of California, the Court found for the Government and included in the deceased's gross estate one-half of the cash surrender value of policies on the life of the surviving husband. An appeal from this decision was taken, but it was dismissed prior to the filing of any briefs.
>
> "The other case arose in the District Court in Washington and the contention of the taxpayer was sustained. Waechter v. United States, D. C. Wash. 1951, 98 F. Supp. 960. This finding of the trial court was affirmed by the Court of Appeals of this Circuit. United States v. Waechter, 1952, 195 F. 2d 963. I am more persuaded by the reasoning of the trial court in this case and by the fact that that decision was upheld by the Court of Appeals. In the Waechter case, a husband and wife were residents of Washington which, like California, is a community property state. On the wife's death the Commissioner sought to include in her gross estate one-half of the cash surrender value of life insurance policies on her surviving husband's life which were purchased with

community funds. The wife was the beneficiary of those policies.

"The District Court held that, based upon an interpretation of Washington law in In re Knight's Estate, 1948, 31 Wash. 2d 813, 199 P. 2d 89, there was no taxable transfer occasioned by the wife's death and there was no interest to which the estate tax would attach. In affirming, the Court of Appeals upheld this view of the case.

"The opinion of the trial judge discloses that he was faced with the same practical obstacle that is present in the instant case, namely, the law of the state does not provide the means by which the wife's executor can obtain possession or control of one-half of the cash surrender value of the policies. As Judge Yankwich so aptly put it:

> "* * * if the contention of the Government be correct, we would have the anomaly to which I referred at the trial, that of requiring the executor to pay a tax on property which *has not come* into, and which he *cannot reduce* to, his possession, under penalty of subjecting the estate to heavy civil penalties, and himself to criminal prosecution, if he willfully avoids doing so.' Waechter v. United States D. C. Wash. 1951, 98 F. Supp. 960, 963.

"There is no material difference between the applicable Washington and California law, and I am convinced that the principle of the Waechter case, supra, should control.

"(6) I believe that this position can be substantiated on other grounds. During her lifetime Mrs. Stewart had a vested right in the policies because the premiums were paid with community

funds and thus the policies themselves were community property. But her husband had the right to deal with those policies in any way he saw fit, because he had the management and control of the community property. Calif. Civ. Code Sec. 172. The one restriction on this right of management is found in the last paragraph of Calif. Civ. Code Sec. 172 which prohibits him from making a gift of community property without the wife's written consent. In the realm of insurance law, this last cited section has been held to give the wife the right to upset the payment of one-half of the proceeds of policies on the husband's life to a stranger. Maxman v. Brown, 12 Cal. App. 2d 272, 55 P. 2d 539. However, the wife's right to contest is not activated until the death of the insured husband, when the gift was completed. Further, if she did not take any steps to invalidate the gift during her lifetime, it became valid upon her death. Mayr v. Arana, 1955, 133 Cal. App. 2d 471, 284 P. 2d 21.

"This interest which Mrs. Stewart had in the insurance policies was, in effect, a right of protection; a right to upset during her lifetime as to one-half in the event that the proceeds were paid to a stranger on Mr. Stewart's death without her consent. But this right of protection did not enure to the benefit of anyone on her death since her death extinguished this right. Both before and after her death he had the right to take the cash surrender value of these policies without her consent, because he had the management and control of the community property. It was only the dissipation of the cash surrender value during her lifetime by way of gift which she could prevent.

"However this right might be classified, I do not believe it comes within the purview of those subsections of the Internal Revenue Code cited by the Government. The principle of the Waechter case, supra, appears to me to be equally applicable to California community property law. I find that the Commissioner was in error in assessing this tax and that the plaintiff should receive the refund prayed for in this cause of action."

It is the Court's view that no interest in the cash surrender value of the insurance policies involved in this case passed by will or inheritance; that a tax imposed on Mrs. Mendenhall's legatees, based on the assumption that something of value passed to them, is completely unjustified; that the interest therein received by Mr. Mendenhall was by reason of the contract of insurance. The Court does not deny that Mr. Mendenhall's position has been improved. The Court does, however, deny that the California inheritance tax statute covers such an interest as he has received, and whether it does or does not should be the prime issue in this case. If such an interest should be taxed, the matter can be submitted to the legislature fairly and clearly as a tax on the transfer of the decedent's interest in the cash surrender value of insurance carried on the life of a person other than the decedent. The Court does not say that it would not be proper to impose a tax on what the surviving husband has received, but it is for the legislature to determine whether such a transfer of interest should be taxed not for the Court to impose a tax on such a transfer

on what seems to the Court the completely untenable theory that he has received it by will or inheritance. The Court would leave legislation to the legislature, particularly the imposition of taxes. It is the Court's further view that the wife's right of protection under Section 172 of the California Civil Code terminated upon her death and that such right did not enure to the benefit of anyone on her death, since her death extinguished the right.

Was the Transfer by the Decedent and Her Husband on March , 1956, to Their Son Ernest Mendenhall, Jr. and His Wife Barbara Mendenhall, a Taxable Transfer?

Under the facts disclosed by the evidence, it is the opinion of the Court that it is not a taxable transfer. Since the gift was of community property the wife contributed only one-half thereof. The property so conveyed was acquired by the decedent and her husband in 1950 for the purpose of giving it to their son to provide a home for him and his family. They gave immediate possession to their son and daughter-in-law, but retained title until by lapse of time they were assured that the divorced wife of their son would not make trouble and cloud the title to the property by some action in the divorce court. The condition of health of Mrs. Mendenhall in 1950 was such that it cannot be said the conveyance was in contemplation of death or made for the purpose of having title pass to avoid being passed by will. The Court further finds that the intention to give the house in 1950 was a part

of a long range program adopted by the parents for the benefit of their son. (*Estate of Snyder*, 71 Cal. App. 324, and *Estate of Adams*, 39 Cal. 2d 309.) The Court further considered that the transfer so made was of an amount not to exceed the immediate needs of the transferees and their family, and that the age and condition of health of the transferor was not the reason for the making of the transfer.

Does the American Trust Company or Ernest Mendenhall, Jr. Have Complete Control of Investments in the Trust? Or Is It a Dual One?

Under paragraph Eighth of the Will on page Twelve thereof, the ultimate decision as to purchase or sale of securities during the term of the trust during the time Ernest D. Mendenhall, Jr. continues to act as Consultant is vested in him, but the Corporate Trust Company is to retain and hold the securities and be in no event liable for any loss that may directly or indirectly result from the Trustee's action in complying with such instructions as may be given by the Consultant. Thus the Court cannot say that either has complete control, but considers that the Consultant has primary control and the Trustee has secondary control.

Should the Trustee Distribute That Portion of Dividends from Mutual Investment Companies Which Represent Capital Gains? Or, Should Such Dividends Representing Capital Gains from Mutual Investment Companies Be Retained by the Trustee As a Part of the Corpus of the Trust?

One of the controlling factors to be considered in determining this question is what was the intent of the testatrix as gleaned from her will. During her lifetime both she and her surviving husband considered and treated the dividends from Mutual Investment Companies as income and not otherwise. The person whom the testatrix was most vitally interested in protecting and assisting was her husband, and had she intended to curtail his income she would no doubt have so expressly provided. Under B. Powers of the Trustee—in subsection (3) on page Nine of the Will full power is given to the trustee to

> "determine, in its sole discretion, what is principal or income of the trust estate."

The Court in reaching its opinion on this matter has given due consideration to Section 5 of the Principal and Income Act of 1914. It is the direction of the Court, therefore, that the Trustee treat all dividends received from Mutual Investment Companies as income and use and disburse it as such in the administration of the testamentary trust.

The other questions submitted need not be answered in view of the decision by the Court of the basic legal question first discussed and decided.

Counsel for the Executor may prepare and submit findings of fact and conclusions of law and order and decree in conformity herewith.

/s/ Gerald C. Thomas
Judge of the Superior Court.

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JAMES R. BROWNING, Clerk

No. 596

# In the Supreme Court of the United States

OCTOBER TERM, 1959

ASHBY O. STEWART, EXECUTOR OF THE LAST WILL AND TESTAMENT OF MARY W. STEWART, DECEASED, PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

## MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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## MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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This case concerns the includibility in a decedent wife's estate of certain insurance policies on the life of her husband. It is uncontroverted that these policies, which were purchased with community property funds, were the community property of decedent and her husband. The question is whether one-half of the cash surrender value of these policies is properly includible in the gross estate of the wife under any of the subdivisions of Section 811 of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.). It is apparently the position of the petitioner that, while

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these policies were community assets, because they were life insurance they somehow took on a unique aspect so that the wife's interest therein was no more than a right of protection should the husband predecease her. Life insurance is accorded the same treatment under the California statutes and cases, however, as is any other asset of the marital community, and under the applicable state law there is no warrant for treating it differently from other community property, the contentions of the taxpayer to the contrary notwithstanding. Section 161a of the Civil Code of California.

This Court has considered another side of this problem in *Lang* v. *Commissioner*, 304 U.S. 264, where it was held that upon the death of a husband, with a wife surviving, only one-half of the proceeds of his life insurance which had been purchased with community funds was includible in his gross estate. It is therefore only logical that upon the wife's prior death the other one-half interest in the policies which she owns should be included in her estate. Indeed, to hold otherwise would open a wide vista for estate tax avoidance since a husband would be able to purchase life insurance upon his life with community assets, secure in the knowledge that under the *Lang* case only one-half of such policies might be included in his estate should he die first; on the other hand, should his wife predecease him her assets would have been depleted for estate tax purposes by the purchase of the insurance but no portion of the insurance would be includible in her gross estate.

Section 811(a) of the Internal Revenue Code of 1939 provides that there shall be included in a decedent's gross estate all property "[t]o the extent of the interest therein of the decedent at the time of his death". At the time of her death, the decedent in this case owned one-half of the cash surrender value of the insurance policies which her husband had taken out on his own life. Under the unequivocal language of the statute, this one-half interest must be included in her gross estate.

The decision of the Superior Court of San Diego County in the *Estate of Meadenhal* (Pet. 31) does not stand in the way. That case holds no more than that under the California inheritance tax laws any interest which the deceased wife might have in such policies did not pass by will or inheritance so as to fall within the purview of the state inheritance tax act.

Even if one assume for the purposes of argument, however, that the husband's action in investing the community assets in insurance on his life had the effect of making a gift on behalf of the wife, half of the insurance would still be includible in her estate. The California cases relating to gifts of community property made by the husband without the written consent of the wife have generally termed such gifts voidable. See, *e.g.*, *Blethen* v. *Pacific Mut. Life Ins. Co.*, 198 Cal. 91, 243 Pac. 431. The position of the taxpayer that the decedent had no more than a right of protection—a right to void the gift—does not help his case. If the interest of the decedent had been no more

than that, her half interest would still be includible in her gross estate, either under the provisions of Section 811(c)(1) or 811(d) of the Code. Section 811(c)(1)(C) includes in gross estate any interest which a decedent has transferred "intended to take effect in possession or enjoyment at or after his death." If decedent be considered to have made a transfer of her interest in the insurance policies, either to her husband or to the contingent beneficiaries, she would have had a right at least until the time of her death to recapture such interest. Any such transfer, therefore, was one which could not take effect until after her death, and the property so transferred must be included in her estate. Similarly, Section 811(d) includes in gross estate any interests transferred where the enjoyment thereof was subject at the date of death to any change through the exercise of a power to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death. If a voidable gift had been made in this case it might have been revoked by decedent up until the time of her death within the meaning of Section 811(d). It would, however, seem more correct to include the policies in the decedent's estate under Section 811(a), as was held by the Court of Appeals. The insurance policies were community property. The wife did nothing to divest herself of her vested undivided interest in such property prior to her death. Her one-half interest was therefore properly held includible in her gross estate.

The decision below is correct and it does not conflict with either state or federal decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1960.

U. S. GOVERNMENT PRINTING OFFICE: 1960